April 10, 2001

Honorable Norman K. Ferguson, Senate Chair
Honorable William R. Savage, House Chair
Joint Standing Committee on Utilities & Energy
115 State House Station
Augusta, ME 04333

Re: LD 1538, An Act to Promote Retail Electricity Competition

Dear Senator Ferguson and Representative Savage:

The Commission will testify in opposition to LD 1538, An Act to Promote Retail Electricity Competition. The Commission will be present at the work session and will be pleased to work with the Committee as it considers this bill.

Section 1 of LD 1538 would require the Commission to consider the extent to which a large bond would pose a barrier to entry, consider all possible forms of security other than bonds, and limit the bond to the likely replacement power cost if the competitive electricity provider should default. These are reasonable requirements but, in our view, need not be placed in law. We considered these issues when developing Chapter 305 of the Commission's rules, and we struck a reasonable balance between consumer protection and acceptance by providers, as we will discuss in subsequent paragraphs.

First, the Committee should be aware that the bonding requirement is different for *standard offer providers* and *non-standard offer providers.* The bonding requirement for *non-standard offer providers* applies only to those serving residential and small commercial customers, and our experience indicates that it has not created a barrier for providers. The level of the surety bond for this group -- $100,000 – is within the range of bonding requirements in other states. To accommodate a provider that finds the bonding requirement to be onerous, Chapter 305 allows the Commission to "grant modifications of this amount commensurate with the nature and scope of the business anticipated to be conducted in Maine" and to modify the bonding level to 10% of the provider's revenues from small customers after one year of operation within the State. Chapter 305 also allows the provider to obtain an irrevocable standby letter of credit in lieu of a bond. Only one provider requested a lower bond level, which we granted.

The bond for *non-standard offer providers* does not protect consumers against the cost of replacement power. Consumers can return to standard offer, thereby limiting their risk to the difference between the standard offer price and the competitive provider's price. Rather, the bond covers funds such as security deposits or other pre-payments that consumers would lose if their provider defaults and fines imposed on the provider by the Commission. Therefore, the bill's requirement to limit the bond to the likely replacement power cost is not relevant for non-standard offer providers.

The bonding requirement for *standard offer providers* is indeed reasonable to examine. We carried out just such an examination after the first standard offer bid process. In response to comments from standard offer bidders, we revised the bonding requirement that existed in the first year to make it less costly for bidders. We will soon carry out a similar examination based on the second year's standard offer bid process, and we may revise the bonding requirement again if bidders indicate that the change would be effective in attracting bidders in the future.

The current standard offer bonding requirement is, in fact, meant to cover the potential cost of replacement power if the standard offer provider defaults, as LD 1538 would require. In this regard, we agree with the intent of the bill. However, while replacement power is the predominant cost protected by the bond, the law should not prohibit allowing the bond to protect consumers from other costs as well, should that become necessary.

Section 2 of LD 1538 would require a standard offer term to be a minimum of one year in duration. While we have favored this minimum in the bidding processes we have carried out, we oppose placing constraints on any future bid duration. In our view, the law should allow maximum flexibility to craft a standard offer approach that responds to changing market conditions. For example, in the current volatile wholesale market, it might be effective to solicit a bid for a very short period of time, thereby allowing a bidder to avoid the risk of future price fluctuations. Another possibility is to stagger standard offer start dates to allow bidders more flexibility to manage their supply. Either of these possibilities could lower the price of the winning standard offer bid. This bill would eliminate both those options.

Section 2 of the bill would also require that the standard offer bid be for a "fixed total per kilowatt hour price" and "include the estimated final cost to provide the full energy and capacity needs" of customers. While we are uncertain what the precise intention of this provision is, we will comment on possible implications.

First, Section 2 appears to prohibit deferring repayment to the standard offer provider of its costs to provide standard offer service. In other words, standard offer customers would pay the full cost of standard offer service in the year it occurs. In general, we agree with this provision and have followed it when setting standard offer prices. Many states have required the standard offer provider (which is often the utility) to charge an artificially low price for standard offer service, to keep the cost of electricity low in the near term. The provider's (or utility's) losses would be made up in future years through prices that are artificially high. In our decisions regarding standard offer price, we have, to the greatest extent possible, avoided this approach. We have approved standard offer prices that cover the underlying cost, thereby avoiding cost-shifting to future customers. However, there have been instances when we averaged costs between years to stabilize the standard offer price over a multi-year period. In each case, we implemented the averaging in a systematic manner that would avoid unpredictable or significant price changes in the future. These instances eased the impact of a sharp price increase on Maine's consumers, but would have been prohibited under the terms of LD 1538.

Second, Section 2 appears to prohibit changing the standard offer price in response to changing market conditions within the first year of its term. This requirement would ensure a stable benchmark for providers who compete against the standard offer provider. We also agree with this provision as a model, and established the State's rules accordingly. However, as with other aspects of standard offer service, we learned that flexibility is necessary to obtain a reasonable price for consumers. When we approved standard offer prices, we stated that those prices would rise if market prices increased significantly. If the standard offer price remained fixed, as this bill would require, we would have had two alternatives – set a far higher initial standard offer price, to hedge against potential market increases, or require future customers to pay back the costs that were not covered by this year's standard offer price. In our view, customers are better served by maintaining the flexibility to adjust to changing conditions.

Finally, Section 2 appears to require that all standard offer customers pay a fixed cent-per-kWh for all kWhs. It is unwise to require that the standard offer be limited to a fixed per-kWh price for the large (i.e., industrial and large commercial) customer groups. A price that varies by time of day and by season or that includes a per-kW charge allows the provider to match revenues to costs and to guard against fluctuating hourly prices. Large customers are accustomed to this price structure, and do not find it burdensome. We suspect that this provision did not intend to prohibit a time-differentiated or seasonally-differentiated price structure. However, if it does, we oppose such a provision because it could increase prices for large customers.

In summary, this bill places into law goals that we already follow when we determine requirements for competitive providers and when we choose standard offer bids. To the extent the bill limits our flexibility in choosing standard offer providers or setting prices, it will *create,* rather than remove, barriers to entry into Maine's electricity market and may increase energy prices for Maine consumers. For these two reasons, we urge the Committee to vote out LD 1538 as "ought not to pass." If you have any questions regarding this matter please contact me.

Sincerely,

Marjorie R. McLaughlin
Legislative Liaison